

FROM BLANK CHECK TO SPAC: THE REGULATOR'S RESPONSE TO THE MARKET, AND THE MARKET'S RESPONSE TO THE REGULATION

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After being used as a part of many fraudulent investment schemes in the 1980s, the blank check company was regulated by the Penny Stock Reform Act of 1990 and SEC Rule 419. Creative lawyers developed the Special Purpose Acquisition Company ("SPAC") as a way to work around the new regulations without defeating the regulations' purpose of investor protection. Although languishing in the late 1990s, the SPAC has grown in popularity in the mid 2000s due to the increasing difficulties faced by small companies looking to raise money through their own initial public offerings ("IPOs"). The SPAC presents an alternative to a traditional IPO and to reliance on private equity. Without giving up control, the management of a small company can use a reverse merger with a SPAC to give their company a cash infusion and have publicly traded shares of stock.

This note traces the regulation of the blank check company, the problems created by the promulgated rules, and the solutions taken by the SPAC. It then looks at the functions of the SPAC within the market, advantages of the SPAC for small companies looking to be bought, and the pros and cons of the SPAC for investors.

The S-1 filing of Highpoint Acquisition Corp., Oct. 10, 2006 includes the following statement:

Highpoint Acquisition Corp. is a blank check company recently organized for the purpose of effecting a merger, capital stock exchange, asset or stock acquisition or other similar business combination with an operating business. We do not have any specific business combination under consideration and we have not (nor has anyone on our

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behalf) contacted any prospective target business or had any discussions, formal or otherwise, with respect to such a transaction. Our efforts in identifying a prospective target business will not be limited to a particular industry, although we intend to focus initially on target businesses in the healthcare industry.¹

This statement is typical of the SPAC,² a new vehicle for raising money in the public capital markets. Does investing in a company with no assets and whose only business plan is to purchase an as-yet unknown company sound risky? It may seem even more so after looking at the shady history of the “blank check” company, of which the SPAC is a modern form. Such companies are “shells” that raise money via an initial public offering (“IPO”), with the stated purpose of merging with an operating company. While it is true that in the 1980s, these companies were frequent vehicles for defrauding unsophisticated investors, the modern SPAC is a post-regulation vehicle with many built-in safety features. Its primary investors are among the most sophisticated—hedge funds—and it appears to have taken its place at the table of legitimate means of raising capital.

Some regulators would have preferred to keep the blank check, in any form, away from the table altogether. In the hearings related to the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (“PSRA”), the U.S. Attorney for the District of Utah stated with regard to blank check initial public offerings, “[w]e find no evidence that these offerings provide any benefit to the U.S. economy or capital formation.”³ Due to the passage of this federal legislation, as well as the strict regulation by Utah and many other states, the number of blank check offerings greatly diminished after the 1980s. There were approximately 2,700 blank check offerings during the Security and Exchange Commission’s (“SEC” or the “Commission”) 1987-1990 combined fiscal years;⁴ in the early 1990s, there were fewer than fifteen. In 1992, the SPAC was developed by a small team of lawyers and underwriters to create a form of blank check company with sufficient investor protection in place to gain the approval of the SEC. The SPAC will be discussed at length in this note, but in the mid to late 1990s, these vehicles faded from the scene, not because of problems with their structure, but due to market conditions: it was easy during this time for small companies to raise money in traditional IPOs.⁵ However, in 2003, activity began to pick up and during the mid-2000s—a period of decline in the number of IPO’s generally in the U.S. capital markets—blank check

¹ Highpoint Acquisition Corp., Amendment No. 2 to Registration Statement (Form S-1/A) (Feb. 2, 2007).

² The original name for these entities is “Specified Purpose Acquisition Company,” but *special* appears to have replaced *specified* in most recent publications.

³ H.R. REP. NO. 101-617 (1990), as reprinted in 1990 U.S.C.A.N. 1408, 1424.

⁴ William M. Prifti, 24 SEC. PUB. & PRIV. OFFERINGS § 7:48 (2006).

⁵ Eric J. Savitz, *The New Blind Pools*, BARRON’S, Dec. 12, 2005, at 21.

offerings, in the form of SPACs, have exhibited a clear growth trend. In 2004, there were twelve issues raising \$0.44 billion; in 2005, there were twenty-nine issues raising \$2.06 billion;⁶ and in 2006, there were thirty-seven, raising almost \$2.7 billion.⁷

This note discusses the regulations that went into effect in 1993 to curb the abuses relating to blank check companies without outlawing them entirely. It also shows how creative lawyering, in cooperation with the SEC, brought into being the legitimate investment vehicle known as the SPAC. The SPAC, while technically exempt from blank check regulation, is modeled on these regulations as a way of ensuring that its structure retains the SEC's approval. The note also evaluates the SPAC in terms of why it is useful to companies looking to raise capital, to investors, and to the managers of this contemporary form of a blank check company.

I. WHAT IS A BLANK CHECK OFFERING?

Before discussing the SPAC, it is necessary to look at the regulatory framework put in place to control the traditional blank check company. A blank check offering is an initial public offering of a company that has been formed for the purpose of raising money and buying an already existing company. It is allowed to offer "penny stock"⁸ for this purpose, but is subject to significant regulation. These regulations are so stringent that they not only removed the usefulness of the blank check as a vehicle for the "pump and dump" schemes of the 1980s, but also made the vehicle unattractive for most legitimate capital raising activity. The PSRA, *inter alia*, added § 77g to the Securities Act of 1933, and defined "blank check company" as follows:

[T]he term "blank check company" means any development stage company that is issuing a penny stock (within the meaning of section 78c(a)(51) of this title) and that—

(A) has no specific business plan or purpose; or

(B) has indicated that its business plan is to merge with an unidentified company or companies.⁹

Section 77g(b)(1) also requires the SEC to "prescribe special rules with respect to registration statements filed by any issuer that is a blank check company."¹⁰ This statute led to SEC Rule 419, to be discussed *infra* at pages 538-39. Since the blank check company has no hard assets, nor even a specific business plan at the time of its offering, other than perhaps a certain industry or geographical region in which it plans to make its

⁶ *Street Scene; Back of the Envelope*, N.Y. TIMES, Sept. 8, 2006, at C6.

⁷ Yung Kim, *US Companies Find Alternate Route to Public Market*, REUTERS NEWS, Dec. 21, 2006.

⁸ *Penny stock* is stock offered for sale for less than \$5 per share.

⁹ 15 U.S.C. § 77g(b)(3) (2006).

¹⁰ 15 U.S.C. § 77g(b)(1) (2006).

purchase, investors are essentially “betting on the jockey”—the expertise of the managers who have formed the company.¹¹ In fact, the management team is often made up of high profile names that are likely to attract investment.

The blank check offering should be distinguished from a “blind pool” offering. While in some states’ regulatory schemes—and in some media reports—the two are not distinguished, SEC Rule 419 (which implemented the 1990 reforms) regards blind pools as having enough specificity in their business plans to fall outside the rule’s requirements.¹² The blind pool, to be sure, is similar to the blank check in that it raises funds to purchase unidentified assets. However, the blind pool is actually a limited partnership or other direct participation program with a specific business plan,¹³ for instance, to use the SEC’s own example, a “real estate limited partnership formed to invest in apartment buildings that have not yet been selected.”¹⁴ The blank check is, after the IPO, a public company, and yet has still less specificity in its plan. Thus, it is subject to more stringent structural requirements for the protection of investors. Primary among these is the fact that at least 85% of the IPO proceeds must be kept in an escrow or trust account, invested in low-risk government securities, until the purchase is made. Additionally, the number of investors who may disapprove of the purchase when proposed is limited to 20% (if the purchase is to go forward), and the company has only eighteen months from the date of the IPO to make its purchase, plus a six month grace period if a deal is announced but not completed by the end of the first eighteen months.¹⁵

II. BLANK CHECKS’ CHECKERED PAST

The purpose of the strict regulation of blank check offerings, as with all regulation, is to curb abuse. The new blank check statute was part of the PSRA. To understand the law and implementing regulations, it is helpful to understand the situation in the late 1980s. Penny stocks were an area fraught with serious abuse,¹⁶ and blank checks were a common way in

¹¹ Karen Richardson & Peter Lattman, *Financiers Now Say ‘Trust Us’ — Like the Blank-Check Offerings of Yore, SPAC Investors are Asked to Buy in — on Faith*, WALL ST. J., Feb. 1, 2007, at C1.

¹² STUART R. COHN, 2 S.E.C. COUNSELING FOR SMALL & EMERGING COMPANIES § 19:19 (2006). The SPAC too falls outside these requirements, but for different reasons. See *infra* Section IV.

¹³ Blank Check Offerings, Securities Act Release No. 33-6932, 51 SEC Docket 284 (Apr. 13, 1992).

¹⁴ *Id.*

¹⁵ Savitz, *supra* note 5, at 21.

¹⁶ The SEC reports that in fiscal 1988, 12.5% of all substantive broker-dealer complaints involved penny stock firms. In 1989, the figure had become 22%. This was despite the fact that penny stock brokers at this time constituted less than 5% of the

which fraudulent activity was carried out.¹⁷ Penny stocks were not registered or approved for registration and were not traded on a national securities exchange.¹⁸ Therefore, they were not subject to regulation prior to the Act. Falling below the SEC's radar and even that of state regulators, they were easily used to manipulate the expectations of unwary individual investors. There were many schemes in which, for instance, broker-dealers operating in a "boiler room" environment, would cold-call potential investors, sell them stocks at inflated prices, and profit from the difference between the mark-up and the actual trading price. In typical legitimate broker-dealer activity, by contrast, the profit comes from a commission. As the legislative history of the Act states:

A common method of perpetrating penny stock fraud is through the marketing of "shell" corporations, or "blank check companies" with no operating history, few employees, few or no discernible assets, and no legitimate likelihood of success in the future. Often the only legally stated purpose of such companies is to seek investment opportunities through mergers and acquisitions.¹⁹

When used in these fraudulent schemes, the blank check offerings were often bought by a collection of friendly brokerage firms or clients, who would then, in collusion, maintain control of the market. Prices were easily manipulated, so that investors could be roped in with a chance to get in on the ground floor. As the blank check company announced its purchase, the salespeople were able to generate great excitement about the company. However, unsuspecting buyers of the stock might be surprised to find that, when they went to cash out of their stock, there was no market available to buy it. The stock was in fact worthless.²⁰

In 1990, penny stocks and blank check companies were truly an area in need of regulation, and the state and federal regulations that went into place accomplished the intended effect of greatly diminishing the abusive practices.²¹ Although thirty-six states completely prohibited or

registered broker dealers in the country. H.R. Rep. 101-617 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1411-12.

¹⁷ The North American Security Administrators Association estimated that, in 1988 alone, public investors lost more than \$2 billion in penny stock schemes. Gerald V. Niesar & David M. Niebauer, *The Small Public Company after the Penny Stock Reform Act of 1990*, 20 SEC. REG. L.J. 227, 239 (1992).

¹⁸ See the definition of "penny stock" at 15 U.S.C. § 78c(a)(51)(A) (2006).

¹⁹ H.R. REP. NO. 101-617 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1413.

²⁰ *Id.* at 1414.

²¹ Randolph Beatty & Padma Kadiyala, *Impact of the Penny Stock Reform Act of 1990 on the Initial Public Offering Market*, 46 J.L. & ECON. 517, 518 (2003), have disputed the success of the PSRA in curbing speculative IPOs. However, although their results show that speculative IPO activity continued after the Act, this does not imply that abusive practices were not in fact reined in by the Act.

substantially restricted blank check companies²² and the federal statute added substantial limitations, blank check companies were not outlawed entirely. This is because, despite the blank check's extensive use within fraudulent schemes, then SEC Chairman Richard Breeden and NASD enforcement director John Pinto agreed that "blank check offerings could be and were used in legitimate business transactions outside the penny stock area."²³ Congress and some of the states chose to adopt the SEC's traditional approach of solving problems through requiring disclosure, in the belief that "sunlight," as "the best of disinfectants,"²⁴ would clear up the problem. What is most interesting is not that the problem was in fact largely cleared up, but that the basic concept of the blank check, like the mythical Phoenix, has risen from the ashes of its past. While deviating structurally in only minor ways from the House Committee Report's description, the new blank check offering is now a significant source of financing, many underwritten by major banks such as Citigroup and Deutsche Bank. In the form of the SPAC, they have lately been a growing niche in the U.S. IPO market.

III. WHAT THE CURRENT RULES REQUIRE

The PSRA stated, at finding (8): "The present regulatory environment has permitted the ascendancy of the use of particular market practices, such as 'reverse mergers,' with shell corporations and 'blank check' offerings, which are used to facilitate manipulation schemes and harm investors."²⁵ To combat these abuses, the environment was changed through regulating the penny stock market generally, for instance, through requiring an automated listing system to replace or at least supplement the unregulated "pink sheets" that were investors' only source of information,²⁶ and by regulating blank check offerings specifically. As to the former, the law requires that an automated quotation system be set up for the trading of penny stocks, removing them from the realm of easily manipulated pink sheet listings. As to the latter, the Act added section (b) to section 7 of the Securities Act of 1933.²⁷ This section of the Securities Act defined blank check companies for purposes of the Act. In arriving at this definition,

²² H.R. REP. NO. 101-617 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1420.

²³ *Id.* at 1424.

²⁴ Robert B. Stevenson, Jr., *The S.E.C. and the New Disclosure*, 62 CORNELL L. REV. 50, 52 (1976) (quoting Brandeis, J.).

²⁵ PSRA, Pub. L. No. 101-429, 104 Stat. 931, 951 (1990).

²⁶ According to the PSRA's legislative history, the pink sheets published the prices at which a dealer was willing to buy and sell specific stocks. The dealer "need only provide a minimal amount of information about the listing company," and "is not legally responsible for the accuracy of the information provided." H.R. REP. NO. 101-617 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1410.

²⁷ 15 U.S.C. § 77(g) (2006).

Congress clearly had in mind those shell companies that were used so effectively to fool investors into thinking they were investing in a growth opportunity when in fact they were investing in next to nothing. And yet, emptiness is a container holding the potential for growth. Holding to the presumption that the legitimate use of the blank check vehicle was possible so long as disclosure kept investors out of the darkness, subsection (b)(1) of the Act provides a framework for regulation. Subsection (b)(1)(A) requires “timely disclosure . . . of (i) information regarding the company to be acquired and the specific application of the proceeds of the offering, or (ii) additional information necessary to prevent such statement from being misleading.” The disclosure rules would be supplemented by investor protection rules. Section (b)(1)(B) places “limitations on the use of such proceeds and the distribution of securities by such issuer until the disclosures required under subparagraph (A) have been made.” Finally, (b)(1)(C) “provide[s] a right of rescission to shareholders of such securities.”²⁸

The definition of penny stock is contained in § 3(a)(51) of the Securities Act of 1934 (as amended).²⁹ This section is meant to track the “designated security” definition from the SEC’s Rule 15c2-6,³⁰ which regulated “cold-calling,” the high pressure telephone sales tactics that were one aspect of the boiler room schemes that used penny stocks and blank check companies to defraud unsophisticated investors. This section of the statute defines the term by excluding securities that were considered sufficiently safe via regulation by either the SEC or the national exchanges. Thus, § 3(a)(51) states:

The term “penny stock” means any equity security other than a security that is—

- (i) registered or approved for registration and traded on a national securities exchange that meets such criteria as the Commission shall prescribe by rule or regulation for purposes of this paragraph;
- (ii) authorized for quotation on an automated quotation system sponsored by a registered securities association, if such system (I) was established and in operation before January 1, 1990, and (II) meets such criteria as the Commission shall prescribe by rule or regulation for purposes of this paragraph;

²⁸ *Id.* A right of rescission means, in this context, that the shareholders, if a merger deal is never consummated, may turn in their shares for a proportional share of the assets of the blank check company — the money remaining in the escrow account.

²⁹ Securities Act of 1934, § 3(a)(51) (codified as amended at 15 U.S.C. § 78c(a)(51)(A) (2006)).

³⁰ Niesar & Niebauer, *supra* note 17, at 248.

(iii) issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C. § 80a-1 et seq.];

(iv) excluded, on the basis of exceeding a minimum price, net tangible assets of the issuer, or other relevant criteria, from the definition of such term by rule or regulation which the Commission shall prescribe for purposes of this paragraph; or

(v) exempted, in whole or part, conditionally or unconditionally, from the definition of such term by rule, regulation, or order prescribed by the Commission.³¹

Exclusion (iv) is particularly important, as it allows an issuer to avoid being classified as a penny stock, either through a minimum price of \$5.00 or higher, or through ensuring that its post-offering net tangible assets will be greater than \$5 million. The use of the second option under this exclusion by the modern day SPAC will be discussed later.

The blank check offering portion of the PSRA was implemented and fleshed out by SEC Rule 419,³² which was designed with the dual purpose of placing strict controls on the proceeds of the blank check offering, and giving investors a chance to reconsider their investment with the knowledge of all the facts of the company, including its acquisition target.³³ The six principal provisions are:

(1) the requirement that IPO proceeds, net of cash paid for underwriting commissions, underwriting expenses and dealer allowances, and the ten percent allowed to the registrant, be kept in an escrow account, where they must remain until the purchase is approved.³⁴ This escrow account must be either (a) an insured depository institution or (b) a separate bank account having a broker or dealer with net capital of at least \$25,000 acting as trustee.

(2) A post-effective amendment is required at such time as a target company is identified as a probable acquisition. This amendment must include the financial statements of the registrant and the target, and pro forma financial information as required by applicable rules and regulations. Because warrants—options to buy shares at a set price—are generally issued with the stock as part of the blank check IPO, Rule 419 implies a continuous offering of the underlying security.³⁵

³¹ 15 U.S.C. § 78c(a)(51)(A) (2006). The implementing regulations, which were updated in 2005, may be found at 17 C.F.R. § 240.3a51-1 (2007).

³² 17 C.F.R. § 230.419 (2007).

³³ Stuart R. Cohn, 2 S.E.C. COUNSELING FOR SMALL & EMERGING COMPANIES § 19:19 (2006).

³⁴ 17 C.F.R. § 230.419(b) (2007).

³⁵ 17 C.F.R. § 230.419(d) (2007). The offering is continuous because when the warrants are exercised, additional stock must be issued to the exerciser. Since outstanding warrants imply that there is additional stock that has not yet been issued,

(3) Another post-effective amendment to the registration statement must be filed when the company executes its acquisition agreement. The purchasers must be sent the prospectus contained in this amendment, and are given between twenty and forty-five business days from the effective date of this amendment to notify the registrant whether they intend to remain an investor.³⁶

(4) If purchaser chooses not to remain, he or she is given rescission rights as to purchaser's investment, plus interest, less certain expenses.³⁷

(5) Restrictions on the release of the offering proceeds from escrow until the purchase conditions have been met, including the condition that the purchase must use at least 80% of the funds raised, both at the IPO and through conversion of the warrants, but not including the amount payable to non-affiliates for underwriting commissions and expenses, and dealer allowances.³⁸

(6) An eighteen month time limit in which the company must buy a target or return the money to the investors.³⁹

Essentially, these restrictions provide substantial protections to investors, largely putting an end to the use of the blank check company as a vehicle for fraud.⁴⁰ The occasional case is still heard in which shell companies are used for blatant market manipulation,⁴¹ but this is minimal compared with the situation in the 1980s; it can safely be said that the regulations stemming from the PSRA have been largely successful in curbing abuse.⁴²

IV. MOVE TO LEGITIMACY: THE SPAC

the SEC recognizes that the original prospectus may become outdated before all stock is issued. Therefore, the Commission requires the filing of updates in the form of post-effective amendments to the registration statement. *See* Harold S. Bloomenthal & Samuel Wolff, 3B SEC. & FED. CORP. LAW § 9.27 (2d ed.).

³⁶ 17 C.F.R. § 230.419(e)(2)(ii) (2007).

³⁷ The fees and expenses range from 8 to 15% of the total. Scott Malone, *IPO VIEW – Crunch Time Coming for Blank-Check Companies*, REUTERS NEWS, Mar. 26, 2006.

³⁸ 17 C.F.R. § 230.419(e)(1) (2007).

³⁹ 17 C.F.R. § 230.419(e)(2)(iv) (2007).

⁴⁰ *But see* Press Release, NASD (Aug. 14, 1997), available at http://www.nasd.com/PressRoom/NewsReleases/1997NewsReleases/NASDW_010512 (discussing a sanction given to GKN Securities, an early SPAC underwriter, and twenty-nine additional brokers for aftermarket manipulation of eight securities it underwrote, including four that were SPACs). *See also* Savitz, *supra* note 5, at 21.

⁴¹ *S.E.C. v. Kern*, 425 F.3d 143 (2d Cir. 2005). The defendant in this case did not work around the regulations; he blatantly disregarded them.

⁴² Note that in 1992, in the period between passage the PSRA and the promulgation of Rule 419, it looked as if the penny stock abuses were beginning to make a comeback, with many of the same players returning to business under new names. Dean Foust, *The Penny-Stock Boys are Back*, BUSINESS WEEK, Jul. 20, 1992, at 76. But the abuses do not appear to have continued to any significant extent into the mid-1990s.

The regulations may have been so limiting that no one would bother to do a blank check offering as a legitimate way of raising funds on the public capital markets. The numerous restrictions made the blank check structure so limiting that it would be difficult to find investors for these vehicles, despite the investor protections that the regulations put in place. No doubt Congress would have been satisfied with this result when they passed the PSRA in 1990.

However, there are times when a blank check-style structure may be an appropriate vehicle for raising money. Thus, in 1992 the SPAC was developed as a way to do blank check IPOs that would not be tarnished by the reputation of the 1980s blank checks, nor limited by the most oppressive features of Rule 419.⁴³ The SPAC is a company that is formed to raise funds in a public stock offering for the purpose of purchasing a business. It was designed even as the SEC was putting Rule 419 together, so that it could avoid certain limitations of Rule 419, while voluntarily adopting the bulk of the rule's requirements. Thus, it is a structure which hews to the regulation even while being technically exempt.

In this manner, the Commission has been satisfied that the SPAC is not being used to perpetrate fraud against investors, while the managers are able to raise public funds and have enough wiggle room to alter the structure in ways that make it attractive to investors. The SPAC uses an exception in the penny stock definition to avoid being subject to Rule 419, and yet, because it follows most requirements of Rule 419, the SEC does not perceive it as a scam in need of being caught within a wider or more tightly woven regulatory net. While SPACs continue to arouse the suspicions of state attorneys general⁴⁴ and occasional questions by the SEC, their prestige has waxed considerably as large, reputable investment banks have taken them on and well-known veterans in various industries have formed and managed them.

It would seem that the obvious way to avoid the penny stock definition, and thus the confines of Rule 419, would be to price the IPO shares at greater than \$5. However, in an SEC Release, the Commission removed this option.⁴⁵ As the Commission stated, "the five dollar price threshold presents an easy mechanism for avoiding the regulatory scheme contemplated by Congress . . . undercut[ting] the investor protection purpose of the blank check rules."⁴⁶ While removing this "easy mechanism," the SEC purposely left in place the exemption for companies

⁴³ Telephone Interview with David Alan Miller, Managing Partner, Graubard Miller, in New York, NY (Jan. 8, 2007). Mr. Miller is an attorney who helped create the modern SPAC structure in the early 1990s.

⁴⁴ Mark Cecil, *State Attorneys General: Set to Attack SPACs*, MERGERS & ACQUISITIONS REPT., Aug. 22, 2005.

⁴⁵ Penny Stock Definition for Purposes of Blank Check Rule, Exchange Act Release No. 33-7024, 55 SEC Docket 722 (Oct. 25, 1993), 17 C.F.R. § 240 (2007).

⁴⁶ *Id.*

with net tangible assets over either (1) \$2 million for a company that has been in continuous operation for more than three years,⁴⁷ or (2) \$5 million for a company in operation less than three years.⁴⁸ Thus, the SPAC was designed to take advantage of this exemption by shaping the offering to leave the company with greater than \$5 million in net tangible assets subsequent to the IPO.⁴⁹

The possession of these assets must be proven by providing audited financial statements as of the offering date to the SEC using form 8-K. These financial statement results are invariably promised within the SPAC prospectus. Essentially, the Commission was willing to work with the issuers to arrive at this solution.⁵⁰ SEC Deputy Director Shelley Parratt has stated, with regard to SPACs, that “our role is not to say people can’t do these deals. Our role is full disclosure.”⁵¹ Since the company does not exist as an operating company prior to the offering, and the offering itself may not net \$5 million, the difference is likely to be made up by either private equity, or by the managers themselves, who are often wealthy former executives (or by both of these groups).

The fact that all SPAC structures are fairly similar, although multiple firms are now structuring them, is a sign that the watchful eye of the SEC is still tightly fixed upon them. The SPAC is, after all, an entity specifically structured to avoid regulation in an area that has been specifically regulated through Rule 419. The SPAC is allowed to continue because it is structured to provide sufficient investor protection so that the purpose of Rule 419 is served even while the SPAC itself remains outside the scope of the rule. It is, in this sense, quite unlike—in fact converse in principle to—structuring a tax shelter by finding a loophole that allows a transaction to remain within the letter of the law while in fact going against the law’s clear purpose. The SPAC meets the purpose of the rule while remaining outside the letter of the regulation through a loophole that the Commission knowingly left in place.

These are a few of the terms by which the SPAC differentiates itself from a blank check offering under Rule 419:

- A 419 offering would not allow for the trading of the common stock or warrants of the blank check company.⁵² This is the feature

⁴⁷ This company would obviously not be a SPAC.

⁴⁸ Penny Stock Definition for Purposes of Blank Check Rule, Securities Act Release No. 33-7024, 55 SEC Docket 722 (Oct. 25, 1993), 17 C.F.R. § 240 (2007).

⁴⁹ Miller, *supra* note 43.

⁵⁰ Penny Stock Definition for Purposes of Blank Check Rule, Securities Act Release No. 33-7024, 55 SEC Docket at 722 (Oct. 25, 1993), 17 C.F.R. § 240 (2007).

⁵¹ Securities & Exchange Commission: *Corporation Finance Reviewed 6K Issuers over Past Year*, Deputy Director Announces, 37 SEC. REG. & LAW REPT. 1881 (Nov. 14, 2005).

⁵² Bruce Rader & Shane de Burca, SPACs: *A Sound Investment or Blind Leap of Faith?* 20 INSIGHTS NO. 1 (2006), at 2, 5.

of the rule that would make the offering unattractive to investors. One would have to buy and hold the shares or warrants for as long as the entire eighteen month period in the hope of a successful transaction. By avoiding the Rule 419 requirements, the stock and warrants of a SPAC are able to trade separately three months after the prospectus date. This separation of trading is what attracts investment by hedge funds, which are able to devise complex trading strategies around both stock and warrants. Were hedge funds not thusly attracted to SPACs, there would be far less interest in the vehicle.

- Investors are also protected from dilution in the SPAC, in that the warrants are generally not exercisable until after the acquisition; Rule 419 allows exercise at any time.⁵³ By requiring the acquisition to come first, the SPAC protects an investor who buys the stock and may sell it prior to the acquisition. It will not be diluted by new shares issued upon the exercise of the warrants.
- The SPAC is an improved vehicle for an acquisition in that it is not in fact limited to the eighteen month period of a Rule 419 blank check company. SPACs have been allowed to take an extra six months to complete a merger if announced within eighteen months, and now they are even taking the extra six months as part of their overall “fuse.” This extra built-in six months is easier to operate than the letter of intent rule. The SPAC will dissolve, however, if no acquisition is made after 24 months.⁵⁴
- While Rule 419 measures the minimum purchase price of the target as 80% of the blank check’s maximum offering proceeds, the SPAC measures it as 80% of its net assets at the time of the acquisition, thus allowing for the use of working capital and including investment income.⁵⁵ This is simply a more realistic measurement to use than that provided in the regulation.

The next two points make the SPAC actually safer than the Rule 419 blank check, protecting all investors, large and small.

- SPAC net offering proceeds are usually invested in U.S. government securities maturing in 180 days or less; Rule 419 allows for any type of government securities, or a money market fund.⁵⁶
- The SPAC often deposits a percentage higher than 90% of its proceeds into the escrow account, while Rule 419 requires just 90%.⁵⁷

⁵³ *Id.*

⁵⁴ Miller, *supra* note 43.

⁵⁵ Rader & de Burca, *supra* note 52, at 5.

⁵⁶ *Id.*

⁵⁷ *Id.*

The final difference is perhaps less safe for the investor, but not of great consequence.

- While no more than 20% of the SPAC investors may vote against the proposed merger if it is to take place, and the dissenters have a conversion right, the investor must specifically exercise this right in order to have the pro rata share of the investment returned. Under Rule 419, the pro rata share will be automatically returned if the investor does not approve the transaction within 45 days of its announcement.⁵⁸ The Rule 419 approach is probably related to the penny stock scams of the 1980s, in which investors were purposely kept in the dark about the status of their investment until the shady broker-dealer made money and the investor was left with valueless shares. But the 419 approach is not necessary for the legitimate activity of the SPAC, which is marketed to sophisticated investors.

A recent, positive development for SPACs has been that the American Stock Exchange (“AMEX”) has begun to list them, giving them a home other than the over-the-counter bulletin board.⁵⁹ This latter development is good for SPACs in two ways: (1) it increases their liquidity and access to capital because a number of states do not recognize the over-the-counter bulletin board,⁶⁰ and (2) it creates an exemption from the Blue Sky laws of all fifty states.⁶¹ While some states’ Blue Sky laws emphasize adequate disclosure, thereby allowing SPACs to register so long as they are truthful in their filings, other states have merit-review laws, according to which state regulators may block the registration of any offering that they deem to be overly risky. Due to the fact that state regulators continue to view SPACs in light of the shady history of blank checks and blind pools as they existed in the 1980s, SPACs generally will not even attempt to register in merit-review states.⁶²

V. SPAC EXAMPLES

Formed in the early 1990s, the modern SPAC went through a dormant period during the dotcom craze of the latter part of that decade. In an environment in which public capital was easy to come by, there was no great need for the SPAC.⁶³ Investors had an appetite for risk, but there was enough risk to go around in the form of traditional IPOs of not-yet-profitable companies with a new business model and no track record. Of

⁵⁸ *Id.*

⁵⁹ As of Feb. 1, 2007, the AMEX lists 23 SPACs, with 25 more on the way. Richardson & Lattman, *supra* note 11, at C1.

⁶⁰ *AMEX Lists Acquisition Vehicles*, 37 WALL ST. LETTER No. 46, Nov. 21, 2005.

⁶¹ Because the AMEX is a designated national exchange listing, it is automatically exempt from state securities registration requirements. Savitz, *supra* note 5, at 22.

⁶² *Id.*

⁶³ Miller, *supra* note 43.

course, by 2003, well after the tech bubble had burst, investors were well aware that having “.com” in a company’s name did not guarantee that company’s success. It has become more difficult for a small company to raise money, and the resurgence of the SPAC has resulted from the latter’s usefulness as a way for a business to raise money without doing its own IPO, and without having to sacrifice a portion of control by turning to private equity. Rather, in a reverse merger transaction, a company may be purchased by a SPAC, giving it a needed cash infusion and making it a public company.

SPACs have been formed in numerous industries, and while not all have successfully merged with a target company, there are many that have. For a more concrete understanding of how the SPAC has functioned as a vehicle to raise cash and purchase a company, there follow a few examples of SPACs that have successfully found targets and consummated acquisition deals.

Services Acquisition Corp. is an example of a SPAC with high profile management that includes former executives from Blockbuster, AutoNation, and Boca Resorts.⁶⁴ Because the investors are betting on the quality of the management, former executives with good track records of creating value are the best asset a SPAC can have. Services Acquisition Corp. raised \$127 million in the summer of 2005, and purchased, in March of 2006, the smoothie chain, Jamba Juice, for \$265 million.⁶⁵ While its stock, issued at \$8, was trading at a mere \$5.80 by January 2007,⁶⁶ there is no reason this smoothie chain should not successfully use the cash raised through the SPAC purchase to expand its operations and achieve a higher stock price. Furthermore, money has already been made. To help fund the Jamba deal, Services Acquisition executed a PIPEs (private investment in public equity) transaction, placing 27.4 million shares of its own common stock at \$7.50 with a group of institutional investors. This led to a temporary jump in the SPAC’s shares to \$11.50 after the deal was announced. The warrants that are typically part of a SPAC offering,⁶⁷ trading separately from the common shares, jumped fourfold to \$4.30,⁶⁸

⁶⁴ Lynn Cowan, *IPO Outlook: Shell Game Draws More Attention—Acquisition Companies are in Position for Debuts; Key Players Still Cautious*, WALL ST. J., Apr. 10, 2006, at C5.

⁶⁵ Colleen Marie O’Connor, *SPAC Strikes Juicy Deal (A Positive Sign for the Industry)*, INVESTMENT DEALER’S DIGEST, Mar. 20, 2006, at 12-13.

⁶⁶ Note that there was a known dilution, of which investors were clearly warned in the S-1 filing, from \$8 to \$5.65 as the result of the shares given to the pre-offering investors (the management) for a nominal price. Serv. Acquisition Corp. Int’l, Amendment No. 4 to Registration Statement (Form S-1), at 21 (Jun. 28, 2005), *available at* <http://www.secinfo.com/dvut2.zHxz.htm#1stPage>.

⁶⁷ In this case, the units issued included one share of common stock and one warrant. *Id.* at 48.

⁶⁸ The warrant generally trades at the difference between the market price of the associated stock and the price at which the warrant allows its holder to purchase the

creating a windfall for their holders.⁶⁹ Typically the primary holders of the warrants, as well as many of the shares, are hedge funds whose strategies involve taking advantage of events such as this.

The SPAC that has received perhaps the most media attention of all was Acquicor, formed by former Apple executives Steve Wozniak, Gil Amelio, and Ellen Hancock. It raised \$173 million at its offering in March 2006,⁷⁰ and purchased Jazz Semiconductor (Jazz) for \$260 million in October of that year.⁷¹ Their stock was at \$5.65 as of January 2007. This purchase presents an example of why a reverse merger with a SPAC is often attractive to the target company. Jazz was having some difficulty raising public funds, having filed to go public in 2004, only to withdraw its offering eighteen months later, citing market conditions. Prior to Acquicor's offer, Jazz, which is 55% owned by private equity firm, Carlyle Group, had filed for a more modest offering.⁷² The Acquicor deal, however, gave it an easier route to get the cash infusion the company needed.

Another high profile SPAC deal is the agreement by Endeavor Acquisition Corp. to purchase American Apparel. American Apparel's CEO, Dov Charney, stated that this transaction is superior to private equity because a company is partnering with the marketplace, rather than a single person or company. Many small businesses prefer, in fact, the public offering precisely because management does not have to give up a large portion of control to a private equity investor. On the other hand, the SPAC reverse merger is a way to avoid the heavy preparation involved in doing one's own IPO, while arriving at essentially the same result. The SPAC managers have already gone through with the offering process.⁷³ Endeavor's offering took place in December 2005, raising \$129.3 million.⁷⁴ Since the purchase price was more than triple that amount, clearly this SPAC had money on hand in addition to that raised in their IPO. The stock of Endeavor was trading above \$11 as of January 2007.

As a final example, Aldabra was a SPAC on the prowl for an acquisition. It had looked at 150 potential targets and performed due diligence on 35 of those.⁷⁵ Then, one of its managers contacted the private

stock, which is generally the original offering price. Hence, in this case, there was approximately an \$8 difference between these prices.

⁶⁹ O'Connor, *supra* note 65.

⁷⁰ Another \$2 million was invested by the management team, at the risk of losing it to the shareholders had they not been able to close a deal on time. Cowan, *supra* note 64.

⁷¹ Olaf de Senerpont Domis, *Take the M&A Train*, DAILY DEAL, Oct. 6, 2006.

⁷² *Id.*

⁷³ Adam Tschorn, *American Apparel Deal Highlights 'SPACs': L.A.-based Firm to be Acquired by Endeavor, a Special-Purpose Acquisition Corporation, for \$398 Million*, DNR, Jan. 1, 2007.

⁷⁴ Stephanie Kang, *American Apparel Seeks Growth Through an Unusual Deal*, WALL ST. J., Dec. 19, 2006, at B1.

⁷⁵ James P. Miller, *Shells Fill in the Blanks for Deals*, CHI. TRIB., Jan. 21, 2007, at C1.

equity firm Madison Dearborn Partners (Madison) to see if the latter had a business in its portfolio that was in need of a capital infusion from outside. Madison suggested Great Lakes Dredge and Dock Corporation (Great Lakes), a company with over \$400 million in annual revenue.⁷⁶ The target looked good to Aldabra; the deal closed on December 27, 2006.⁷⁷ Control did not exactly change hands—post merger, Madison held 67% of the shares, Aldabra 28%, and Great Lakes the remaining 5%.⁷⁸ But Great Lakes got a \$50 million cash infusion,⁷⁹ and is now a public company. The significance of the transaction, aside from the prestige factor of being a public company, is that Great Lakes may now use stock rather than cash to make future acquisitions, and Madison can sell some or all of its 26 million shares if it so decides.⁸⁰ The Aldabra investors have profited; the original \$6 shares were trading at \$6.87 as of January 2007, while the freely trading warrants, two of which were included with each share as one “unit” in the IPO, were trading at \$1.76 each, making the \$6 investment worth a total of \$10.39.⁸¹

VI. WHY THE INTEREST IN SPACs?

The question concerning the SPAC’s function in the marketplace—what purpose are they serving for the various affected parties—will be examined briefly from the point of view of each of the parties with some interest in the SPAC.

A. *Underwriter Interest*

For the investment banks, the lure of the SPAC is simply that it generates a healthy fee. It has been reported that the typical SPAC underwriting fee is 10%, which is larger than the standard IPO fee of 7%.⁸² However, this fee structure applies only to smaller deals, which are allowed higher fees by the NASD. The new, larger SPAC offerings have the standard 7% fee, and a portion of that is deferred until the business combination is successfully completed. While there are some underwriters who have specialized in the SPAC since the mid-1990s, such as EarlyBird Capital, more recently such major players as Citigroup, Inc., Merrill Lynch & Co., and Deutsche Bank, have underwritten SPACs. The underwriters’ interest in SPACs is a reflection, not of an outsize fee, but of the industry’s

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ James P. Miller, *Shells Fill in the Blanks for Deals*, CHI. TRIB., Jan. 21, 2007, at C1.

⁸¹ *Id.*

⁸² Jenny Anderson, *Crave Huge Risk? This Investment May Be for You*, N.Y. TIMES, Sept. 23, 2005, at C7.

acceptance of this vehicle as an area of growth in an otherwise declining IPO market. The fact that the large banks are willing to get involved is also a clear sign that the prestige of the SPAC has left its seedy reputation from the 1980s behind. Were that not the case, these banks would not be putting their own valuable reputations on the line.

B. *In the View of the Target Company*

Other reasons for the SPAC's gain in popularity have to do with the target side of the acquisition. A SPAC may be a way for a smaller company to raise cash without having to do an IPO of its own. Ten years after the heady days of the late 1990s, there is little interest in the market for small company IPOs. This leaves such companies with few options to raise cash.⁸³ As stated previously, not all operating company management teams want to give up a portion of control to private equity investors. Additionally, a standard public offering raises money that must go to help finance the company. But what if the present owners want some cash out of the deal? If management prefers to cash out, then allowing the company to be purchased by a SPAC means they will not have to sell their own shares in the public market. Their own shares can be among those purchased by the SPAC.⁸⁴ Besides being convenient in some cases for management, some of these companies might have a hard time getting to the public market.⁸⁵

C. *Advantages for the Founders*

Additionally, the SPAC might be a way for managers and dealmakers who have some experience, but are presently without a company to call home, to get back in the game by raising money and buying a company to manage. Certainly, the SPAC provides a good vehicle. Although the managers do not receive a salary or other compensation from the SPAC, the SPAC may include a service agreement that allows it to pay a monthly fee for office space and administrative support.⁸⁶ Additionally, a portion of the net offering proceeds that are not

⁸³ *Id.*

⁸⁴ Steve Rosenbush, *Are Blank Checks Bouncing Back?*, BUS. WK. ONLINE, Mar. 23, 2006, http://www.businessweek.com/investor/content/mar2006/pi20060323_176623.htm.

⁸⁵ Savitz, *supra* note 5, at 22.

⁸⁶ Cynthia Krus & Harry S. Pangas, *United States: The SPAC Phenomenon: A Discussion of the Background, Structure and Recent Developments Involving Special Purpose Acquisition Companies*, Jul. 24, 2006, available at <http://www.mondaq.co.uk/article.asp?articleid=41456&searchresults=1>. Per e-mail from David Alan Miller to author (Feb. 5, 2007) (on file with author), this benefits the SPAC itself more than it does the managers personally.

held in escrow will be used to pay for directors' and officers' insurance⁸⁷ and legal and accounting expenses. The costs of due diligence on prospective targets, as well as the costs of negotiation, structuring, and gaining shareholder approval for the merger, will also be paid from this money.⁸⁸ The funds that will go to pay for these expenses collectively may be considered the working capital of the SPAC. Clearly it is convenient for the management team to have this fund available as it searches for and attempts to complete its business combination. And once the purchase is made, the managers, who are generally required to have some "skin in the game," stand to profit significantly from their own investment in the company.

D. *For the Investors*

The primary investors in SPACs have been hedge funds. The typical SPAC IPO includes units made up of one common share plus two warrants. The whole unit sells for \$6 or \$8 initially, but the warrants will detach and trade separately within weeks after the IPO.⁸⁹ Hedge funds generally are able to devise strategies involving the separately traded warrants and shares that do not depend on the success of the underlying business that is acquired.⁹⁰ Small hedge funds play it relatively safe by buying the shares on the secondary market, warrants already detached. These shares often trade at a substantial discount to the cash held in the escrow or trust account. This is equivalent to buying cash at a discount (e.g. if the acquisition does not take place and the SPAC folds), with an option to sell or hold after the announcement that a company will be purchased. Most likely the shares would be sold after the upswing resulting from the announcement.⁹¹

The relatively small investor has also been gaining interest in SPACs. The reason is simple: it is a way of getting exposure to private

⁸⁷ Directors and Officers Liability Insurance ("D&O Insurance") protects against claims related to the Securities Act of 1933 and the Securities Exchange Act of 1934. SPACs' unique structure presents several unusual coverage issues such as the limited corporate existence (fuse of 18 to 24 months), the corporate purpose being focused entirely on a business combination which will result in change in control, the placement of at least 80% of the offering proceeds in a trust or escrow account, and the fact that, for its limited life, it is a public company with no operating business or financial results. Randi-Jean G. Hedin & Karen G. Narwold, *Directors and Officers Liability Insurance Issues for Special Purpose Acquisition Corporations*, 14 METROPOLITAN CORP. COUNSEL, Dec. 2006, at 46, available at <http://www.metrocorpcounsel.com/pdf/2006/December/46.pdf>.

⁸⁸ Krus & Pangas, *supra* note 86.

⁸⁹ Karen Richardson, *Ahead of the Tape*, WALL ST. J., Nov. 18, 2005, at C1.

⁹⁰ Savitz, *supra* note 5, at 22. See also Dan Primack, *Why SPACs are Luring VCs into Public Market*, VENTURE CAP. J., Oct. 1, 2005.

⁹¹ This strategy is discussed in Richardson, *supra* note 89.

equity style deals without having millions of dollars to invest.⁹² The shares are trading at low prices on the open market, so the potential for large gains exist. Although technically exempt from Rule 419, SPACs adopt the rule's safety nets for investors, such as required disclosure, the ability to vote on the acquisition, and the ability to receive a proportional share of the trust fund upon finding oneself in a minority of investors who do not approve of the deal (essentially a put-option). Of course, the risk is still large because one's investment languishes in a trust fund that invests in government securities for up to two years, after which the money may be returned, with the fund's income, but net of the allowable expenses. Further, the requirement that 80% of the assets must be spent on a single company purchase means that the managers have but one bet to make; it had better be a good one. Holding the shares is as risky as investing in any other single small cap growth company.

Then, of course, there is private equity. Private equity has an interest in doing SPACs as a way of tapping the public capital market for additional funds. For the private equity firm, it is a low-risk and low-cost way to leverage the public markets while backing entire management teams.⁹³ Additionally, a private equity firm may be in desperate need of these funds. For example, McCown De Leeuw & Co. was out of money from its fourth fund and, given some mediocre results, would not have been able to raise additional funds from private sources. Instead of folding, they were able to use a SPAC to raise funds and continue to place bets.⁹⁴

VII. INVESTMENT DANGERS WITH SPACS

Without doubt, the SPAC remains a risky investment. It still possesses no assets other than management's professed know-how. In addition to the high amount of risk involved in investing in a company with no assets or business plan, there are specific risks associated with SPACs. The investor is basically betting on the management to make a wise purchase decision and to negotiate a good deal. Yet, even where one is confident in management's ability, there are structural reasons why SPACs could run into problems. University of Florida finance professor Jay Ritter has noted that the eighteen month deadline, while protecting investors by forcing a return of their money if no deal is transacted, also puts management under severe time pressure. "In terms of the executives involved, they've got every incentive to do a deal, whether it makes sense or not, because if they don't do one, they give the money back . . . If they do a deal, that entitles them to a gravy train of salary for the foreseeable

⁹² Martin Sikora, *Blank Checks Add Buyers*, MERGERS & ACQUISITIONS: THE DEALMAKER'S JOURNAL, Mar. 1, 2006.

⁹³ Primack, *supra* note 90.

⁹⁴ Andrew Dolbeck, *Risky Business: Gambling on SPAC Investments*, WKLY. CORP. GROWTH REP. 1, Oct. 3, 2005, at 2.

future,” says Ritter.⁹⁵ And salary may not be the main consideration. The managers typically receive a 20% interest in the SPAC, a percentage which does not share in the liquidation proceeds if a deal is not made. If the deal is made, however, this 20% becomes quite valuable. So, as the eighteen month deadline approaches, the managers face a do or die situation in which the SPAC structure and built in incentives result in high pressure to do some kind of deal, or give up the ship. This, together with the fact that they must spend 80% of the invested money on their deal, a fact of which the target’s own management and owners are well aware, could lead to the SPAC’s overpaying for the target company.⁹⁶

On the other hand, investors can block a deal they do not like, and have been known to do so. As of January 2007, four of the 2005 to 2006 SPACs have had their deals blocked, and those SPACs have folded as a result.⁹⁷ This may be viewed as a good sign, in that the investors are taking charge of the SPAC. The SPAC cannot be said to be a vehicle for manipulating investors, as the 1980s blank check companies so often were. The downsides of a blocked deal are that the target company has wasted three to six months in negotiations, and the investors who approved the deal—which could be up to 79%—will have to get their money back, net of fees and expenses which can range from 8 to 15% of the total.⁹⁸ An additional downside for the SPAC managers, besides the blow to their egos, is that their required investments in the SPAC warrants become worthless.⁹⁹ All of these downsides are, however, normal functions of a market in which risk is a part of the ground rules. The ability of the SPAC investors to nix a deal is important in light of the built-in pressures on management to find a deal.

VIII. EFFECT ON CAPITAL MARKETS

Thus far, the effect on U.S. capital markets of the recent surge in blank check IPOs has been positive, at least in the sense that their growth has provided some additional business in an otherwise declining domestic IPO market. However, the impact on the market for businesses—in which SPACs compete with other investment groups such as private equity—is potentially negative. The competition created by SPACs, especially with the limitations on the SPACs’ investment options, could make it harder for the private equity industry, and other investors, to find targets selling for a

⁹⁵ Scott Malone, *Crunch Time Coming for Blank-Check Companies*, REUTERS NEWS, Mar. 26, 2006.

⁹⁶ Savitz, *supra*, note 5, at 22.

⁹⁷ Ken MacFadyen, *Market Awaits SPAC Flood as Deal Deadlines Approach*, INVESTMENT DEALERS’ DIGEST, Jan. 29, 2007.

⁹⁸ Malone, *supra* note 95.

⁹⁹ *Id.*

good price.¹⁰⁰ An overall price increase in target companies will lower returns for all takeover investors.

SPACs are also useful for getting U.S. listings for foreign companies. A number of recent SPAC prospectuses have narrowed their industry focus to China, or a specific industry in China, for instance.¹⁰¹ Examples include: Great Wall Acquisition Corporation, which held its IPO in March of 2004¹⁰² and merged with ChinaCast Communication Corporation;¹⁰³ China Mineral Acquisition Corporation, whose offering was in May of 2004,¹⁰⁴ which dissolved after being unable to complete an acquisition;¹⁰⁵ and Shanghai Century Acquisition Corporation, which had its IPO in April 2006.¹⁰⁶ SPACs are a way for Chinese companies to go public in the United States without going through the difficult listing process. The trend is likely to continue, with companies from other growing economies, such as India, joining the game.¹⁰⁷ Of course, once listed, they will have to follow the rules of U.S. securities markets, but the SPAC has cleared one difficult hurdle for them—the American IPO.

Although there are bound to be some failures, the SEC would be ill-advised to further regulate the SPAC. As a result of added securities regulation, businesses tend to move to European markets, such as Euronext and the British AIM, to raise capital. In the present state of regulation, although a few SPACs have been done on the AIM, large scale movement to that self-regulated market is unlikely. The advantages of the AIM are that the IPO and business combination process are both much easier in that market. A British SPAC is a nimbler vehicle, with listing taking up to four months less time than in the U.S., and a much easier approval process for the SPAC's purchase.¹⁰⁸ However, IPO shares may be sold in the U.S. only to qualified institutional buyers,¹⁰⁹ and such shares are not freely tradable by these U.S. buyers on the AIM; they must be held for a period of one year

¹⁰⁰ *Id.*

¹⁰¹ There were five SPACs in 2006 that raised money (\$250 million in total) to purchase companies in China. Leslie P. Norton, *Swimming in a Perilous Pool*, BARRON'S, Jan. 8, 2007, at 32.

¹⁰² Great Wall Acquisition Corp., Registration Statement (Form S-1), at 1 (Mar. 9, 2004).

¹⁰³ Great Wall Acquisition Corp., Current Report (Form 8-K) (Dec. 22, 2006).

¹⁰⁴ China Mineral Acquisition Corp., Registration Statement (Form S-1), at 1 (May 28, 2004).

¹⁰⁵ China Mineral Acquisition Corp., Current Report (Form 8-K), exhibit 99.1 (Nov. 27, 2006).

¹⁰⁶ Shanghai Century Acquisition Corp., Prospectus (Form 424B3), at 3 (Apr. 25, 2006).

¹⁰⁷ Barbara A. Jones, *Business Combinations with Chinese Companies Pose Challenges for Due Diligence and Ongoing Reporting Obligations*, 14 METROPOLITAN CORP. COUNSEL, Dec. 2006, at 65, available at <http://www.metrocorpcounsel.com/pdf/2006/December/65.pdf>.

¹⁰⁸ Colleen Marie O'Connor, *SPACs Take Flight on London's AIM*, INVESTMENT DEALER'S DIGEST, Nov. 7, 2005, at 9-10.

¹⁰⁹ "Qualified institutional buyer" is defined at 17 C.F.R. § 230.144A(a)(1)(i) (2007).

or more under most circumstances.¹¹⁰ Finally, while absence of regulation is helpful to the managers, the complete lack of investor protection creates a situation too much like the pre-regulated U.S. market in which blank checks were subject to significant abuse. This is enough to keep the majority of SPAC business in the U.S. under the current regulatory scheme.¹¹¹ In the U.S. now, the relationship between SPACs and the SEC is a good one; investors are protected while money can be raised to buy a company. While the AIM is not an immediate danger as a competitor, the situation could change if the regulatory climate in the U.S. were to change significantly.

IX. CONCLUSION

The anti-blank check attitude of the early 1990s, before the SPAC came on the scene, needs to be revised. It was sensible in 1992 to make statements like the following:

Promoters claim that this 'shell game' is a cheaper and more attractive way for a small company to go public; in reality, however, it has almost never resulted in a benefit to the former private operating company . . . [T]he rare success . . . occurs in spite of the public shell, not because of it. A problem for the merged company is trying to find legitimate accountants, lawyers, and brokers willing to be associated with its future capital raising needs.¹¹²

In 2006, not only are the legitimate professionals willing to work on SPACs, but there are numerous examples of successful SPACs, a handful of which have been discussed in this paper, with more likely to follow as the SPACs of 2005 and 2006 continue to make their acquisitions.

As to the future of the blank check company, the Wall Street Journal has pessimistically noted that "there is a broad range of quality in the deals being presented, and all it will take to kill the structure is for a handful to blow up."¹¹³ Only time will tell. In the meantime, blank checks—in the legitimized form of the SPAC—appear to have fully overcome their early reputation developed during the boiler room days of the 1980s. With a structure designed to satisfy the SEC that its investors are sufficiently protected, the SPAC is an example of legal creativity preventing a promulgated regulation from damping a legitimate need within the market. As a result, the SPAC is becoming an established part of mainstream capital markets activity.

¹¹⁰ Miller, *supra* note 86.

¹¹¹ Miller, *supra* note 81.

¹¹² Niesar & Niebauer, *supra* note 17, at 242-43.

¹¹³ Cowan, *supra* note 64, at C5.